COMMUNICATIONS

A Stabilized Dollar

In the December number of the AMERICAN ECONOMIC REVIEW Mr. C. C. Arbuthnot presents some interesting objections to Fisher's plan for a "stabilized dollar."[1] Arbuthnot arrives finally at the conclusion that Fisher's plan would not eliminate the alternate fluctuations in business from boom periods to depressions and that in the post-crisis period the "stabilized dollar" would produce more violent drops in prices than those to be experienced under our present monetary system. To demonstrate that the price *drops* would be more violent it becomes necessary for Arbuthnot to prove that under the Fisher plan the upward swings in prices would be almost as pronounced as those we would experience otherwise. For unless the price level rises high it can't drop far. In the argument over this point Arbuthnot is forced to tackle the old question as to whether credit expansion is the cause or the result of rising prices. He concludes that when bank credit is employed not for investment purposes but "to assist in the purchase and sale of marketable goods" and "takes the form of short-time notes which are to be paid from the receipts from the sold goods . . . [the] extension of credit is accompanied almost simultaneously by an offer in the market of salable commodities, the equilibrium between supply and demand is not seriously disturbed and the extension of credit has no lifting influence on the general level of prices."[2] Consequently Fisher must be in error in insisting that inflation explains such rises in prices as could be modified by the "stabilized dollar."

Now the writer conceives that this analysis involves certain errors; that the fact of the speedy emergence of the goods on the market is of no great pertinence in explaining the relation between expanding grants of commercial credit and rising prices. As the writer has pointed out elsewhere[3] the effect of increasing commercial credits on prices is largely a matter of the industrial circumstances of the time. In some situations easy credit must be followed by rising prices; in other situations it may not be so followed; but in no situation is the quick appearance of the goods on the market the sole criterion as to the effect on prices. If the writer's conception is correct in this matter the attacks on the Fisher propaganda must be of a different sort.

Let us assume that we are in the midst of a boom period. Let us assume that manufacturers in general have pushed production as far as can be without increasing the expenses per unit of output. Let us assume that additional good labor is not easily available, and that employment of further labor is expensive, if for no other reason, because the best labor was absorbed first. Certain necessary materials can be obtained in additional quantities only by bidding against manufacturers in other industries who are also behind in their orders. Finally, it may be that extra-production will necessitate enlargement of buildings, changes in machinery, or other expensive alterations.

Under these circumstances our retailers, jobbers, or wholesalers are informed by the banks that they will be treated liberally in their requests

[1] See C. C. Arbuthnot, "A Stabilized Dollar Would Produce Violent Changes in Periods of Falling Prices," AMERICAN ECONOMIC REVIEW, vol. X (December, 1920), pp. 776-784.

[2] *Ibid.*, pp. 779-780.

[3] *Cf.* H. L. Reed, "Work of the Federal Reserve Board," *Journal of Political Economy*, January, 1921.

for commercial credit. They are simply given large lines of credit. What must be the effect to retailer *A* of liberal extensions of credit lines to competing retailers, *B*, *C*, and *D*? Obviously it is likely to encourage lively bidding between the retailers for the limited quantity of available goods. Taking advantage of this situation the manufacturers shove up prices, and all down the line from producer to consumer this advance is passed along. With the same easy credits, and difficulties of expanding inexpensively, in other fields of industry, there is gradually diffused throughout the community the buying power in terms of dollars, in anticipation of which retailers bid for goods and fix their prices. Even though the goods are not withheld indefinitely from the market they make their appearance under changed conditions of supply and demand.

Clearly the situation would have been different if manufacturers had known that retailers could obtain commercial credit only with difficulty. There would not then have been the same opportunity to play off one buyer against another, and the market could not have been made so easily a sellers' market. Why then assert that banks with their credit offers did not help to create the rise in prices? Explanation of this common mistake is undoubtedly to be found in the fact that in each individual transaction economists have customarily focused attention upon the credit finally granted rather than the credit which competitors of the successful bidder for the goods could have had. If *A* gets the goods instead of *B*, *C*, or *D* it appears that the amount *A* borrows depends upon the height of prices rather than the reverse. But, though the prices may have been fixed before credit is called into being, the prices *A* had to pay and the volume of bank credit actually created for *A* was influenced by the amount of credit *B*, *C*, *D*, or others could have got had they been the successful bidders for the goods. If this be true the adjusting of the volume of the circulating media to the level of prices, as under the Fisher plan, might aid in restraining rapid rises by limiting the amount of credit *available* to competing retailers.[4] In other words, Arbuthnot's objection is due to his inability to see that the amount of commercial credit available for the prospective borrower determines, among other considerations, the amount finally extended to the actual borrower.

Of course under differing industrial conditions liberal credit offers need not have the same effects. Suppose the situation is one in which additional labor and materials are easily available, that new orders need not necessitate enlargements of plants or changes in equipment. Larger production may create possibilities of economy in the amount of overhead or fixed charges allocated to each unit of output. If, under these circumstances, retailers are stimulated to a reasonable extent by information that the required credit will be forthcoming, prices are not necessarily disturbed. As a matter of fact they may even be lowered in that the retailers' orders may make possible production under conditions of greater efficiency. It may no longer be a matter of setting up greater dollar competition for the limited quantity of goods but rather using more dollars to effect the transfer of more goods. Easy and abundant credit may thus affect either the level of prices or the volume of production or both. Undoubtedly the situations in which prices and production are both affected outnumber the cases in which abundant credit works upon the one alone. But as to which is most in-

[4] Particularly in times when bank reserves are low.

fluenced an a priori answer is not possible. It all depends on the industrial situation.

If the foregoing be correct, Arbuthnot's objections fall. But Fisher's plan would then be subject to attack on the following grounds: (a) Production rather than price statistics should determine the need for a change in the volume of dollars. (b) Because of the all importance of bank credit in our media of exchange Fisher's efforts should be confined to endeavors to influence the policy of our bankers and particularly the Federal Reserve Board rather than to attempt the more difficult and less promising task of securing the assent of a far larger number of minds to what appears to be a radical change in our monetary system.

In regard to the first we must recall that Fisher would adjust the volume of the circulating media as prices rise or fall. Suppose, as is undoubtedly frequently the situation, that production increases cannot be effected without easier credit which if granted may bring about some rise in prices. In this situation should we not take the position that price stability is primarily a consideration of distributive justice and should be subordinated to the requirements of rendering as large as possible the total volume of production? Should we not first of all adapt our credit policy to production needs and then consider the measures necessary for securing fair distribution?

In the second place, under certain favoring circumstances such as plentiful reserves, the banks could easily nullify any effect created by the change in the theoretical weight of the dollar. Unless our banking administration can be taught a different price theory than any they have thus far enunciated clearly the possibilities of a "stabilized dollar" are limited. But if bankers can be induced to limit their credit grants to the requirements of productive efficiency we need not worry about such matters as the invention of new processes for mining gold or the importation of gold from abroad. Despite great difficulties will it not be easier to educate our bankers, and having educated them to make use of existing machinery, than to attempt to convince the far larger class whose assent to the "stabilized dollar" would be necessary? At any rate it will not be necessary to argue for a change which will *appear* violently to alter our present monetary system.

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Integration in Marketing

In the September number of this Review Mr. Lewis H. Haney analyzes the reasons for integration in marketing (which amounts to what is commonly referred to as elimination of middlemen) and attempts to answer the question whether the tendency in this direction is in the public benefit.[1] His general conclusion is that, although integration may be socially desirable within certain limits, there exists "no prima facie case for integration in marketing." Broadly speaking, the conclusions uphold the orthodox system of marketing, especially where the wholesale grocer is concerned, and appear to find little justification for such innovations as the chain store, mail-order house, coöperative buying exchanges, or direct sale from manufacturer to retailer.

[1] "Integration in Marketing," by Lewis H. Haney, American Economic Review, vol. X (Sept., 1920), p. 528.